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No. 83-2038

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1984

J. DONALD GOODWIN,

Petitioner

v.

ELKINS & CO., ROBERT G. HAYDEN, RICHARD SICHENZIO, and GABRIEL F. NAGY,

Respondents

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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COUNTERSTATEMENT OF QUESTION PRESENTED

Whether the court properly held, on the record before it, that Petitioner's general partnership interest was not, as a matter of law, a security.

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Opinions Below

The opinion of the Court of Appeals is reported at 730 F.2d 99 (3d Cir. 1984), and is found in Petitioner's Appendix "A" (hereinafter the "Appendix"). The opinion of the District Court for the Eastern District of Pennsylvania is reported at 558 F. Supp. 1375 (E.D. Pa. 1983) and is found in Petitioner's Appendix "B".

Counterstatement of the Case

Petitioner, J. Donald Goodwin, commenced this action against Respondents, alleging that by reason of their misrepresentations he was induced to resign from Elkins & Co. (the Respondent limited partnership) ef-

fective January 1, 1982, to his financial detriment. Petitioner asserted claims under the Federal Securities laws, alleging that the surrender of his general partnership interest in Elkins constituted the sale of a "security" and accordingly, the alleged misconduct gave rise to a claim under Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder. Petitioner also asserted claims under the common law.

Respondents moved to dismiss the claims asserted under the Federal Securities laws for failure to state a claim upon which relief could be granted. At the same time, Respondents moved to have the Court direct that the remaining claims — all under the common law — be arbitrated by reason of applicable provisions requiring arbitration *inter alia* in the Elkins partnership agreement. The District Court, per the Honorable John P. Fullam, granted the motion to dismiss the securities claims and to compel arbitration of the common law claims. The United States Court of Appeals for the Third Circuit affirmed.

REASONS FOR DENYING THE WRIT

A. The Decision of the Third Circuit Does not Conflict with the Decisions of Other Courts of Appeals.

The judges in the Court of Appeals each wrote a separate opinion, concluding, in affirming the motion to dismiss, that no security was involved. The guide-post for all three opinions was a recognition of the reality of Petitioner's legal powers and rights, and a recognition that the *existence* of legal powers and rights — not the degree of control over partnership affairs that could be or was exercised — was the dispositive factor in determining whether a security existed.

Chief Judge Seitz found that Petitioner's "rights and responsibilities" under the partnership agreement created a "degree of participation in partnership affairs" inconsistent with being the holder of a security. Appendix,

A-25. He then found that the complaint simply did not allege that Goodwin was *deprived* of the management prerogatives granted on the face of the partnership agreement. Appendix, A-27. Judge Becker recognized that the test announced in *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U.S. 293 (1946), and its progeny "basically attempts to separate passive investments from active, participatory interests in business." Appendix, A-30. After considering the *powers* accorded Petitioner under the partnership agreement, Judge Becker concluded that they clearly negated investor status, a result reinforced by the lack of any allegation that the partnership agreement was a sham. Finally, Judge Garth found a "quantum of powers and responsibilities" (Appendix, A-16) inconsistent with security status both in the rights enjoyed under state partnership law as well as under the partnership agreement.[1]

The cases which address the issue of whether a general partnership interest can be a "security" look, at bottom, to the *existence* of legal powers and rights. Those cases which suggest that a general partnership interest can be a security do so when faced with invest-

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1. Petitioner contends that Judge Garth, whose opinion announced the judgment of the Court, rested his views on the statutory powers of a general partner as *in and of themselves* legally sufficient to preclude security status. Judge Garth, however, specifically stated that this portion of the opinion (Part III.A.) represented only *his* views. As Judge Garth stated (Appendix, A-8, emphasis supplied):

> Accordingly, to the extent that I reach the same result as my two colleagues, but do so *wholly by reference to the Pennsylvania Partnership Act*, this portion of the opinion (the remainder of Part III. A.) express only my views and not those of Chief Judge Seitz or Judge Becker.

Judge Garth then considered, in Part III.B. of the opinion, Petitioner's powers under the partnership agreement *in conjunction with* the provisions of state partnership law, and concluded that Petitioner's interest did not qualify as an investment security within the meaning of the federal securities law.

ment vehicles which, in effect, "masquerade" as general partnerships — vehicles organized in such a fashion so as evade the protections of the securities law and which, in reality, constitute *investment* vehicles with passive investors having *no* bona fide managerial powers or prerogatives.[2] The decision of the Third Circuit, consistent with the decisions of other Courts of Appeal, represents an effort — *in the context of the record before it* — to determine the *existence* of legal rights and powers and therefore whether the partnership interest at issue had the characteristics of an investment. Respondents therefore see no conflict between the decision of the Third Circuit and those of other Courts of Appeals.

B. The Case was Correctly Decided by the Court of Appeals.

Petitioner alleged that he had been a general partner of Elkins, a securities brokerage firm, for twenty years (Appendix, A-3). That Elkins was not an investment vehicle "masquerading" as a general partnership is alone confirmed by its long-standing existence and Petitioner's long-standing membership as a partner.

In addition, the terms of the partnership agreement reserved ultimate management functions to the general partners. As Judge Garth stated:

> For example, the Partnership Agreement provides that any general partner may participate in the nomination, election, or removal of the Executive Committee and the Managing Partner. Partnership Agreement ¶6, App. at 45. The general partners as a group also maintain ultimate managerial control

2. The language of *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), *cert denied*, 454 U.S. 897 (1982), heavily relied on by Petitioner, was arguably if not in actuality dicta. Compare Appendix A-14 with A-25. Moreover, we submit the "test" articulated in *Williamson* simply established criteria to denominate whether a general partnership lacked *bona fides*.

through oversight of the Executive Committee and the Managing Partner. *Id.* ¶7(a), App. at 45-46. General partners must approve new admissions into the partnership and involuntary terminations of the partnership. *Id.* ¶¶21(a)(i) & 23(a), App. at 60-61. All of these powers, even if Goodwin failed to exercise them, provided him with a substantial role in the management of the firm notwithstanding any restrictions specified by the Agreement.[3]

Most importantly, Goodwin at no time alleged that Elkins was a sham general partnership whose partnership agreement was a sham (Appendix, A-30), nor denied that he in fact had the power of a partner under the partnership agreement (Appendix, A-27).

For these reasons, the decision of the Court of Appeals was manifestly correct.

C. The Result Urged by Petitioner Would Make Unsound Public Policy.

Petitioner would opt for a rule which would authorize a case-by-case inquisition behind every partnership agreement into the degrees of partner control to determine whether the control *exercised* was sufficiently meaningful. Such a rule would invite chaos.

Moreover, the rule sought by Petitioner would result in the needless meddling of the securities laws in the affairs of ongoing businesses organized as partnerships whose partners have active, participatory roles in the business itself. The notion of a security, and the concept

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3. Judge Becker further noted (Appendix, A-30):

[T]he agreement provides that "[e]ach partner will devote substantially all of his business time and attention to the business of the partnership" (¶7(b)), that partners "will not, during the continuance of the Partnership, carry on or be concerned with or interested in . . . any other business or venture other than as herein provided" (¶(c)), and that partnership interests may not be assigned (¶22).

of investment it imports, is antithetical to general partnerships which conduct ongoing businesses where partners have active, participatory interests but delegate management functions to certain persons elected from their number. As Judge Garth suggested, this could include a large Wall Street law firm with 54 partners. *See* Appendix, A-16. In a complex organization, delegation of powers is typically a managerial fact of life and any one partner, who may nonetheless have substantial legal powers and rights to participate in the management of the partnership, may find himself in the minority. Stripped to its essence, Petitioner really complains of his status as a minority partner who could not control the outcome of partnership business. The securities laws are not the cure for the malady, since the anti-fraud provisions are not intended to remedy every wrong that occurs in a partnership scheme. To apply the anti-fraud provisions as Petitioner urges would create an unwarranted intrusion of the federal securities laws into intra-partnership affairs, and result in an improper attempt to "federalize" the state law of partnership.

CONCLUSION

For the reasons stated above, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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4. Pursuant to Rule 28.1, Respondents make the following disclosure: Elkins & Co. is a general partnership. Neither Elkins nor any other respondent is a corporation nor has corporate parents, subsidiaries or affiliates. In 1982, various assets of Elkins were acquired by Bache Halsey Stuart Shields Incorporated, now Prudential-Bache Securities, Inc.